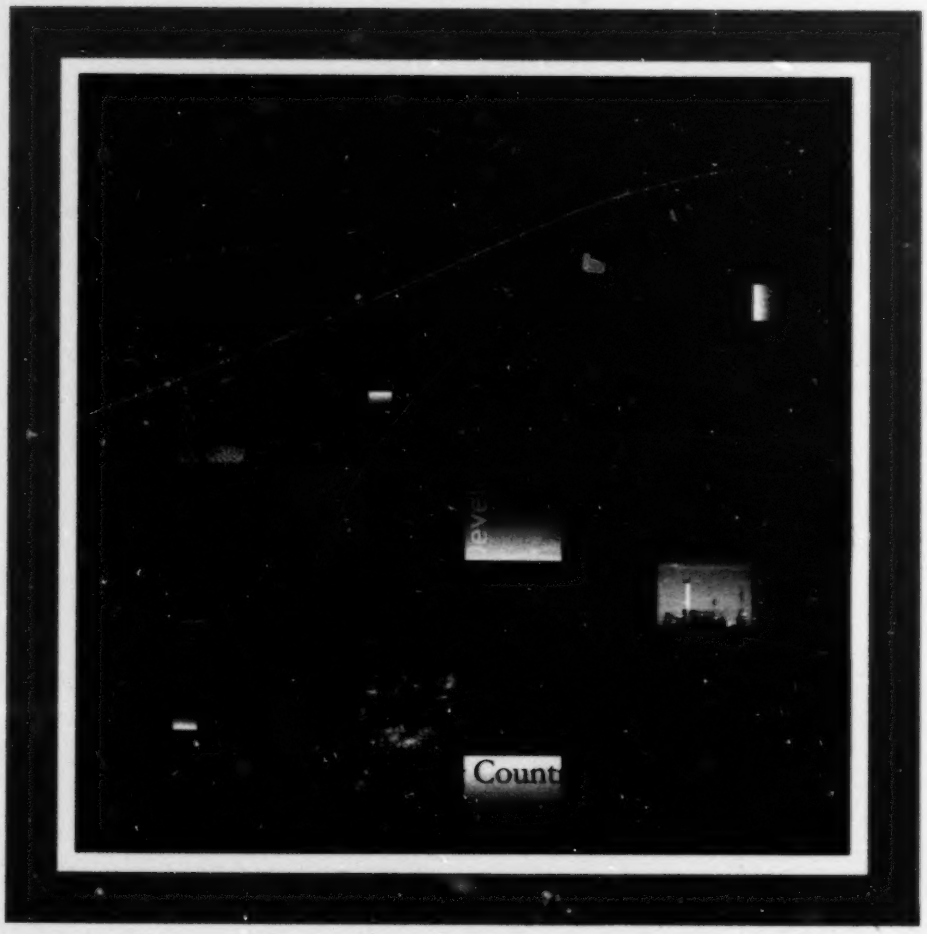
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT, 2002

OVERVIEW

UNITED NATIONS

EMBARGO
The contents of this Report must not be quoted or summarized in the print, broadcast or electronic media, before
29 April 2002 17:00 hrs GMT



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

TRADE AND DEVELOPMENT REPORT, 2002

OVERVIEW

UNITED NATIONS
New York and Geneva, 2002

Note

- Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

- The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

- Material in this publication may be freely quoted or reprinted, but acknowledgement is requested, together with a reference to the document number. A copy of the publication containing the quotation or reprint should be sent to the UNCTAD secretariat.

- The Overview contained herein is also issued as part of the *Trade and Development Report, 2002* (UNCTAD/TDR/(2002), sales number E.02-II-D.2).

UNCTAD/TDR/(2002)(Overview)

OVERVIEW

It is a sign of troubled times when, in the search for solutions to the most pressing policy challenges of the day, it is considered necessary to look to earlier generations for guidance: a Marshall Plan – this time to fight global poverty – a Tobin tax to check financial volatility and a Keynesian spending package to combat deflationary dangers spring readily to mind. The source of the trouble is the gap between the rhetoric and the reality of a liberal international economic order. Nowhere is this gap more evident than in the international trading system. Even as Governments extol the virtues of free trade, they are only too willing to intervene to protect their domestic constituencies that feel threatened by the cold winds of international competition. Such remnants of neo-mercantilist thinking have done much to unbalance the bargain struck during the Uruguay Round.

Since the third session of the WTO Ministerial Conference, held in Seattle, a renewed effort has been made to address the concerns of developing countries, culminating in a different kind of bargain being struck at Doha. Developing countries, by agreeing to a comprehensive programme of work and negotiations, demonstrated their commitment to tackling global political and economic threats; in return, they expect that development concerns will be central to the negotiations.

The challenge is now to translate an expanded negotiating agenda into a truly development agenda.

One voice from the past stands out in the search for a more balanced trading system. In his statement to the first United Nations Conference on Trade and Development in March 1964, Raúl Prebisch, its then Secretary-General, called on the industrial countries not to underestimate the basic challenge facing developing countries in the existing system:

> *We believe that developing countries must not be forced to develop inwardly – which will happen if they are not helped to develop outwardly through an appropriate international policy. We also deem it undesirable to accept recommendations which tend to lower mass consumption in order to increase capitalization, either because of the lack of adequate foreign resources or because such resources are lost owing to adverse terms of trade.*

Prebisch understood that recommending "the free play of market forces" between unequal trading partners would only punish poorer commodity exporters at the same time as it brought advantages to the rich industrial core. His agenda to attack the persistent trade imbalance and create the essential external conditions for accelerating the rate of growth included new modalities of participation for developing countries in the trading system which would guarantee price stabilization and improved market access for primary exports, allow greater policy space to develop local industries and reduce barriers to their exports, establish more appropriate terms of accession to the multilateral system and reduce the burden of debt servicing. Although the participation of developing countries in the trading system has since gone through important changes, the minimum agenda put forward by Prebisch remains the basis for rebalancing that system in support of development.

Global trends and prospects

Growth in the world economy slowed sharply in 2001; performance was weak in all three leading economic regions in the developed world, and the spillover effects on developing countries were much stronger than in previous downturns in the 1990s. Several emerging-market economies in East Asia and Latin America entered into recession; only China and India, two large and relatively closed economies, were by and large immune from the downward pressure of world markets. Growth in Africa remained at a level similar to that of the previous year. For developing countries as a whole growth was only 2.1 per cent, down from 5.4 per cent in the previous year.

The United States economy entered into recession, and the belief that the Euro area would be unaffected proved unfounded. Faltering exports, lower profits of affiliates in the United States, and an overly cautious monetary and fiscal response all contributed to a decline in the growth rate for the Euro area in 2001 to about 1.5 per cent. Unemployment, which had been falling for three years, stabilized at the relatively high level of 8.5 per cent. Of the large EU economies, only the United Kingdom had a more favourable experience, thanks to strong consumer demand. The recovery in Japan, which began in 1999, dissipated in the second half of the

following year, and since the second quarter of 2001 the economy has been in recession, with exports and private investment declining at double-digit rates. Despite the return of the Japanese central bank to its zero interest rate policy in March 2001, companies are reporting record losses, corporate bankruptcies have been rising, and unemployment has edged up to 5.5 per cent.

International trade played a major role in transmitting the slowdown in the industrial world to developing countries. After growing by 14 per cent in 2000, export volumes for developing countries grew by less than 1 per cent in 2001. All major developing regions were affected, but the impact was most marked in East and South Asia, where exports had grown particularly fast in 2000 thanks in large part to strong demand for electronic products and semiconductors in the United States; the decline in exports is estimated to have been more than 15 per cent for Taiwan Province of China, 10 per cent for the Republic of Korea and 5 per cent for Hong Kong (China), Malaysia, Singapore and Thailand. In some regions, slower growth in export volumes was compounded by falling prices, especially in Latin America, which suffered from substantial declines in the prices of its commodity exports. The sharp drop in petroleum prices from their peak in late 2000 also reduced revenues for oil exporters. By contrast, prices for some commodities exported by African countries held up well in 2001.

Capital flows to developing countries in 2001 remained at the low levels prevailing since the Asian financial crisis in 1997, and suffered a severe setback in the aftermath of 11 September. The economic slowdown and the loosening of monetary policy in the United States had been expected to encourage capital flows to emerging markets for reasons similar to those applying in the early 1990s. However, the lingering uncertainty surrounding these markets after a series of financial crises has been compounded by increased vulnerability to the downturn in industrial countries. Since, in contrast to the situation in the early 1990s, growth in devel-

oping countries today is more directly linked to that of the United States, those countries provide less scope for diversification to investors seeking higher risk-adjusted rates of return. Loan repayments to foreign banks by East Asian borrowers have continued to exceed new loans elsewhere by a considerable margin, and securitized debt continues to flow to developing countries at a slower pace. Foreign direct investment (FDI) has held up better: flows to Latin America made that region the largest net recipient of capital flows. However, the resilience of FDI seems unlikely to persist into 2002. Only China, which saw net inflows rise in 2001, seems likely to continue attracting inflows on an even larger scale, now that it has acceded to the WTO.

Exchange rates in developing countries have been relatively stable. The major exceptions were Argentina and Turkey, which were forced to float their currencies, provoking in both cases considerable financial turmoil. In Argentina the abandonment of the currency peg was associated with a much broader economic crisis, the full consequences of which for both the country itself and its neighbours are not yet clear. However, there has been no widespread contagion of other emerging markets. Since the beginning of 2001 there has been further movement among developing countries towards the adoption of floating exchange-rate regimes, usually coupled with official willingness to intervene to prevent large movements in rates.

Despite the concerted response from the world's most important central banks following the events of 11 September, only in the United States has policy been consistently focused on limiting the impact of the slowdown on employment and real income. The Stability and Growth Pact of the Euro area has led to the pursuit of deficit targets with insufficient regard to the cyclical positions of different countries. While a weak euro has helped maintain foreign demand, from a global perspective monetary policy in the Euro area has also been restrictive. In Japan hopes seem to be pinned on

a weak yen to ignite an export-led recovery. However, recovery also requires increased consumer expenditure, which monetary policy alone is unlikely to be capable of achieving.

Thus, much still hinges on the strength of the United States recovery. So far, despite the rise in unemployment and a slower growth of real wages, stronger-than-expected consumer spending has limited the drop in output. With private savings still extremely low, a sustained recovery will have to be compatible with a return of private households to normal spending habits. At the same time, corporate balance sheets are likely to require further restructuring and the potential of monetary expansion for achieving a revival of investment seems limited. There will be a sustained recovery only if consumer and business confidence is sufficiently buoyant to convince producers that they need to increase investment in new productive capacity. As yet, there are few indications that this is the case.

In the light of the above, a likely outcome is that the United States economy would stabilize at a low, but positive, rate of growth. Such an eventuality would have limited knock-on effects for Europe and Japan, both of which are still dependent on an export-led upturn. Moreover, if the dollar remains strong at the same time as growth in Europe and Japan remains sluggish, the current-account deficit of the United States may widen even further, with the danger of heightened protectionist pressures in that country and a risk that a large eventual dollar devaluation may usher in a period of more generalized currency instability.

As a result of active policies to stimulate domestic demand, most Asian economies returned to positive growth in the last quarter of 2001. Some Latin American and transition economies also managed to buck the global trend earlier in the year. However, growth in the industrial world is unlikely to return quickly to the 3 per cent that appears to be necessary to support a vigorous in-

crease in employment and income in the developing world. Reaching such an objective would require substantial increases in demand for developing-country exports, a major recovery in commodity prices, and a strong increase in capital flows, for which there is little prospect at present.

Least affected by unfavourable external conditions will be the emerging markets in East and South Asia, which have recently been running current-account surpluses and generally have relatively high ratios of foreign exchange reserves to short-term external indebtedness. By contrast, most Latin American countries will require greater capital inflows in order to finance more vigorous growth. In several transition economies in Europe growth is also dependent on the dynamism of exports markets in the Euro area as well as on capital inflows.

In such a context of slow global growth, improved market access could provide a useful boost to activity in developing countries, and greater use of regional trade and financing mechanisms may provide relief from external constraints and protection against financial instability. Nevertheless, many developing countries will continue to require substantial official financial support if they are to be protected from the effects of the difficult external economic environment.

Developing countries in world trade

Fundamentally, the basic policy challenge facing most developing countries remains how best to channel the elemental forces of trade and industry to wealth creation and the satisfaction of human wants. Shifting away from their dependence on the export of primary commodities towards greater production and exports of industrial products has often been viewed as a means of their participating more effectively in the international division of labour. Manufactures are expected to offer better prospects for export earnings not only because they allow for a more rapid productivity growth and expansion of production, but also because they hold out the promise of greater price stability even as volumes expand, thereby avoiding the declining terms of trade that have frustrated the long-term growth performance of many commodity-dependent economies.

Since the early 1980s, moves to rapidly liberalize trade and FDI have strongly influenced policy makers in many developing countries in their thinking about this challenge. Openness to international market forces and competition was expected to allow those countries to alter both the pace and the pattern of their participation in international trade, thereby overcoming balance-of-payments problems and accelerating growth, to catch up with industrial countries.

During this period, the exports of developing countries have, indeed, grown faster than the world average and now account for almost one third of world merchandise trade. Much of that growth has been in manufactures, which today account for 70 per cent of developing country exports; for some products developing country exports account for around half or more of world exports. More importantly, many developing countries appear to have succeeded in moving into technology-intensive manufactured exports, which have been among the most rapidly growing products in world trade over the past two decades, notably electronic and electrical goods.

However, on closer examination, the picture is much more nuanced. With the exception of a few East Asian first-tier newly industrializing economies (NIEs) with a significant industrial base, which were already closely integrated into the global trading system, developing country exports are still concentrated on products derived essentially from the exploitation of natural resources and the use of unskilled labour, which have limited prospects for productivity growth and lack dynamism in world markets. Statistics showing a considerable expansion of technology-intensive, supply-dynamic, high-value-added exports from developing countries are misleading. Such products indeed appear to be exported by developing countries, but in reality those countries are often involved in the low-skill assembly stages of international production chains organized by transnational corporations (TNCs). Most of the technology and skills are embodied in imported parts and components, and much of the value added accrues to producers in more advanced countries where these parts and components are produced, and to the TNCs which organize such production networks.

Indeed, while the share of developing countries in world manufacturing exports, including those of rapidly growing high-tech products, has been expanding rapidly, the income earned from such activities by these countries does not appear to share in this dynamism. On this score, a comparison between the developed and

developing countries over the past two decades raises some initial worries. Although developed countries now have a lower share in world manufacturing exports, they have actually increased their share in world manufacturing value added over this period. Developing countries, by contrast, have achieved a steeply rising ratio of manufactured exports to gross domestic product (GDP), but without a significant upward trend in the ratio of manufacturing value added to GDP. Accordingly, the increase in the shares of developing countries in world manufacturing exports has not been accompanied by concomitant increases in their shares in world manufacturing value added, and in several countries the two ratios have tended to move in opposite directions. Certainly, few of the countries which pursued rapid liberalization of trade and investment and experienced a rapid growth in manufacturing exports over the past two decades achieved a significant increase in their shares in world manufacturing income.

Clearly, for many developing countries, getting the most out of the international trading system is no longer just a matter of shifting away from commodity exports. At the same time, many of the same forces that adversely affected price and productivity dynamics in the primary sector, including the competitive structure of markets, income elasticities and technological weaknesses, need to be re-examined in the light of recent trends associated with the increased participation of developing countries in the international trading system.

Dynamic products in world trade

Over the past two decades the value of world merchandise exports has grown at an average rate of around 8 per cent per annum, compared to less than 6 per cent growth in global output and income (in current dollars). Among the 225 products examined in this *TDR*, exports of some have grown at rates three times as fast as the growth in global income, whereas for others export values have declined in absolute terms. It is mainly primary commodities, but also some manufactures, that have registered sluggish or negative growth rates. The growth of trade in about one third of all products, including both primary commodities and manufactures, has lagged behind the growth of global income.

While manufactures generally constitute the fastest-growing products in world trade, there are also some agricultural products in this group, such as non-alcoholic beverages and cereals. Many of the fastest-growing manufactures in world trade, such as electronic and electrical goods, which now account for around one sixth of world exports, tend to be technology-intensive, often with a high research and development (R&D) content. A common feature of these market-dynamic manufactures is that the sectors in which they are produced exhibit strong productivity growth. This is less so for other market-dynamic products, such as textiles and clothing, and transport equipment, which have low- or medium-skill contents.

Differences in income elasticities, product innovation and changing consumption patterns, and shifts in competitiveness of industries across countries, can explain why some products are more dynamic in world markets than others. However, differences in the speed of liberalization of markets have also played a significant role. A particularly important influence in recent years has been the commercial policies of many developed countries, which limit access to their markets. Trade liberalization has been limited and

slow in textiles and clothing along with other labour-intensive manufactures, compared to the pace of liberalization in other sectors. High tariffs and tariff escalation have been compounded by other overt forms of protection such as tariff rate quotas, as well as by the adverse impact of anti-dumping actions and product standards. The growing number of non-tariff barriers, especially against unsophisticated manufactures, has reinforced the prevailing patterns of market access, which favour high-tech products over low- and middle-range products that tend to gain importance in the early stages of industrialization.

Perhaps a more decisive influence on product dynamism has been the strategy of TNCs. The three product groups with the fastest growth rates over the past two decades, namely components and parts for electrical and electronic goods, labour-intensive products such as clothing, and goods with a high R&D content, have been most affected by the globalization of production processes through international production-sharing arrangements. The increased mobility of capital, together with continued restrictions over labour movements, has extended the reach of international production networks, thereby accelerating the growth of trade in a number of sectors where production chains can be split up and located in different countries. Favourable tariff provisions, often through regional arrangements, and fiscal and other incentives have encouraged this process, promoting a new pattern of trade whereby goods are processed in several locations before reaching final consumers, and the total value of trade recorded in such products exceeds their value added by a considerable margin. Trade based on specialization within such networks is estimated to account for up to 30 per cent of world exports.

Trade and industry: new linkages, old challenges

While developing countries as a whole appear to have become more active and dynamic participants in world trade over the past two decades, closer examination shows a great deal of diversity in the modalities of their participation in the international division of labour:

- First, many countries have not been able to move away from primary commodities, the markets for which are relatively stagnant or declining. However, growth in trade in several primary commodities has been as rapid as in some manufactures, and countries which have successfully entered such sectors have experienced a significant expansion in their exports and incomes;

- Second, most developing countries that have been able to shift from primary commodities to manufactures have done so by focusing on resource-based, labour-intensive products, which generally lack dynamism in world markets;

- Third, a number of developing countries have seen their exports rise rapidly in skill- and technology-intensive products which have enjoyed a rapid expansion in world trade in the past two decades. However, with some notable exceptions, the involvement of developing countries in such products is confined to labour-intensive, assembly-type processes with little value added. Consequently, the share of some of these countries in world manufacturing income actually fell. For others, increases in manufacturing value added lagged considerably behind their recorded shares in world manufacturing trade;

- Finally, a few countries have seen sharp increases in their shares in world manufacturing value added which matched or exceeded increases in their shares in world manufacturing

trade. This group includes some East Asian NIEs which had already achieved considerable progress in industrialization before the recent shift to export drive in the developing world. None of the countries which have rapidly liberalized trade and investment in the past two decades is in this group.

Thus, most developing countries are still exporting resource- and labour-intensive products, effectively relying on their supplies of cheap, low-skilled, labour to compete. With the exception of the last group, they do not appear to have been able to establish a dynamic nexus between exports and income growth that would allow them to rapidly close the income gap with industrial countries. Although they as a whole appear to have become major players in world markets for dynamic products, they still account for only 10 per cent of world exports of products which score high in R&D content, technological complexity and/or economies of scale.

Making sense of a system in which many developing countries are vigorously expanding their foreign trade but are not rewarded by a comparable rise in income requires some hard thinking. A first step is to break with a casual style of empiricism, which takes the classification of manufactured traded goods at face value. Generally, developing countries participating in high-technology sectors are not involved in the skill- and technology-intensive parts of the overall production process. Consequently, their contribution to value added is determined by the cost of the least scarce and weakest factor, namely unskilled labour, whereas the rewards to scarce but internationally mobile factors such as capital, management and know-how are reaped by their foreign owners. It is thus the labour itself, rather than the product of labour, that is exported. Indeed, even in countries such as China and Malaysia, which have been highly successful in raising their shares in world manufacturing exports and value added through participation in international production chains, an important part of domestic value added is captured by profits earned on FDI.

Clearly, participation in the labour-intensive segments of international production networks can yield considerable benefits for countries in the early stages of industrialization and with a great deal of surplus labour. It can enable them to increase employment and per capita income even when value added generated is low. Furthermore, increased employment of low-skilled labour in activities linked to international production networks – whether organized by large TNCs producing a standardized set of goods in several locations, or through groups of smaller enterprises located in different countries and linked through international subcontracting – has certainly widened the possible range of sectors where industrialization can begin and the basic techniques and organizational skills, which are prerequisites for a more broad-based growth, can be acquired. However, that does not constitute a leap into a new pattern of rapid and sustained industrial growth.

These networks allow TNCs a good deal more flexibility in, and control over, their choice of investment locations. Moreover, their productive assets, such as know-how, design and technology, can be locked more tightly inside the firm thanks to barriers of entry that result from the high costs of managing and coordinating such complex units. The packaged nature of FDI can, in these circumstances, be the cause of a highly skewed distribution of the gains from trade and investment unless local bargaining power can bring a more balanced outcome, as it did for the first-tier East Asian economies. However, replicating the success of those countries is all the more difficult where such investment is highly mobile: locational advantages are easily won and lost through small cost changes or the emergence of alternative sites, giving rise to the danger of enclave economies where there is a persistently high dependence on imported inputs such as capital and intermediate goods. These problems can be particularly serious for middle-income countries which have been successful in early stages of industrialization but which now need rapid upgrading and productivity growth in order to advance further along the development path.

Competition and the fallacy of composition

What a country can earn from its participation in the trading system, including through value chains, depends, *inter alia*, on the global supply of the goods produced and exported relative to demand. Unfavourable trends on both counts, resulting in declining terms of trade for commodities, have been a longstanding source of anxiety for policy makers in developing countries. Relying on manufactured exports to galvanize growth was regarded as a solution to this problem.

As a result of increased participation of several highly populated, low-income countries in world trade in recent years, as much as 70 per cent of the labour force employed in sectors participating in world trade is low-skilled. However, there is still a considerable amount of surplus labour in such countries, and many large countries are not yet fully integrated into the international trading system. Thus, a simultaneous export drive by developing countries in labour-intensive manufactures, or increased competition among them to attract FDI as locations for labour-intensive processes of otherwise high-tech activities organized in international production networks, could rekindle the fallacy of composition problem, upsetting the development aspirations of outward-oriented economies and creating serious systemic tensions in the trading system. The dangers of overproducing standardized mass products with a high import dependence are typified by the electronics sector, where developing country export prices appear to be more volatile and to have fallen more steeply after 1995 than the same products traded among developed countries.

There are also more general signs that the prices of manufactured exports from developing countries have been weakening vis-à-vis those of the industrial countries in recent years. It is true that those developing countries that have achieved an impressive export programme on the basis of a dynamic manufacturing sector,

such as the Republic of Korea, have also enjoyed favourable terms of trade with other developing countries, especially those exporting simple manufactures. Coupled with the fact that prices for a number of important developing country manufactures also appear to be increasingly volatile, there are grounds for concern. The design of export-oriented policies accordingly needs to take into account the probability of oversupply in the markets for labour-intensive manufactured exports from developing countries.

Because of the significant barriers to entry in high-skill and technology product lines associated with their high R&D contents and the high costs involved in organizing production chains, these markets are dominated by oligopolistic northern producers usually competing on the basis of quality, design, marketing, branding and product differentiation, rather than price. Final products that are less technology-intensive, such as machinery or transport equipment, which require the financing of very large and specific investments, are also among those with the highest concentration ratios of export market shares.

By contrast, the markets for labour-intensive goods have tended to be a good deal more competitive, especially in the past decade. These markets continue to provide opportunities for the new generation of industrializing economies. But weak growth and high unemployment in the advanced industrial economies have slowed the closure of their sunset industries. Moreover, most middle-income developing countries also persist in labour-intensive manufactures because their producers are finding it difficult to upgrade and diversify. Competitive pressures are further compounded by the way labour markets in developing countries accommodate the additional supply of labour-intensive goods through flexible wages, allowing firms to compete on the basis of price without undermining profitability. Competition among firms, including international firms, in developing countries becomes competition among labour located in different countries.

With a growing number of developing countries, including some with very large unskilled labour pools, turning to export-oriented strategies, it is the middle-income countries in Latin America and South-East Asia that appear most vulnerable to these dynamics. In particular, greater price competition in products of the electronics sector appears to have increasingly exposed traditional developing country exporters to the emergence of more competitive suppliers in countries with lower costs. In the absence of a rapid upgrading to high-skill manufactures needed to enable them to compete with more advanced industrial countries, these exporters may face a squeeze between the top and bottom ends of the markets for manufactures.

Implications of China's accession to the WTO

The accession of China to the WTO has raised the issue of the possible impact of the adoption of multilateral trade disciplines on the trade performance of China itself as well as of its trading partners. For China, it implies, above all, opening up its markets to greater foreign competition and commercial presence. The experience of liberalization episodes in Latin America and transition economies suggests that this can pose a challenge to economic policy makers. However, China's big advantage is that it is joining the multilateral system from a position of strength: spectacular success in export expansion; a sound and sustained balance-of-payments position; and abundant international reserves. Moreover, it is well placed to resist excessive import pressures linked to repressed consumer demand, which have derailed other liberalization episodes.

The most difficult challenges will be faced by enterprises and workers in the State-owned sector. These enterprises operate in agriculture, but are particularly prominent in heavy industry, in-

cluding power, steel, chemicals and armaments, as well as the service sector. At the end of the 1990s they employed over 80 million people, and accounted for 38 per cent of GDP and about half of the country's total exports. Although reforms have been ongoing in this sector for well over a decade, many of the enterprises are in a weak financial position, operating at a sub-optimal level with outdated technologies and relying on high levels of protection. The terms of accession – notably removal of subsidies, reduction of tariffs and non-tariff measures, and elimination of preferential treatment – will exert considerable pressure on many of these enterprises, particularly as the competition will come mainly from firms in advanced countries. Considerable losses of jobs would seem unavoidable for both unskilled and skilled workers.

The consequences of restructuring and increasing unemployment in vulnerable sectors can be offset through industrial expansion elsewhere. Sectors such as clothing, electrical equipment, leather products and other light industries are expected to enjoy improved export opportunities following accession. The recent increase in inward FDI suggests that low labour and infrastructure costs remain a powerful attraction. However, it is unlikely that FDI will generate a large number of jobs; while exports from foreign-owned firms now account for more than 10 per cent of GDP, these firms employ less than 1 per cent of the total labour force. Even if employment in export industries dominated by these firms were to double, they cannot be expected to absorb more than a fraction of labour released elsewhere in the economy. Moreover, these firms are heavily dependent on imports, on top of which there is an outflow of profits, resulting in a net outflow of foreign exchange. Although an important part of total profits is reinvested, this contribution of foreign-funded enterprises to the balance of payments bears a certain resemblance to some countries in East Asia, such as Malaysia, before the outbreak of the financial crisis. If FDI simply serves to relocate labour-intensive processes to China, such an approach may create trade-offs and stiffer competition among

countries with surplus labour and a high degree of reliance on FDI. Such an outcome can be avoided to the extent that FDI is used for technological upgrading and greater attention is paid to the role of domestic markets in absorbing surplus labour.

The growing presence of Chinese exporters is a matter of concern to many developing countries with a similar trading structure. Nevertheless, and despite low wages, China does not have an across-the-board cost advantage in manufacturing over other developing countries because of low productivity, particularly in the State-owned sectors. In labour-intensive manufacturing, including assembly operations in electronics, it is middle-income producers, such as the members of ASEAN and Mexico, that face the greatest exposure, particularly on third markets. These highly competitive markets are precisely the ones most vulnerable to the risk of fallacy of composition.

Concerns are heightened because the trading opportunities from further opening of the Chinese market are unlikely to favour to its potential export competitors. China's imports are biased towards high-skill products and natural resources. Advanced industrial countries and the first-tier East Asia NIEs are likely to gain most, either because of an increased demand for imported parts and machinery linked to production networks or because of sizeable cost advantages over Chinese producers. However, liberalization of China's agricultural imports can be expected to present new export opportunities not only for some Asian countries, which already have high shares in China's imports of such products, but also for some Latin American and African countries.

China's challenge to integrate further into the world economy will require a full range of policies to smooth the adjustment process and maintain solid growth. It is important that it retain its autonomy and the option to use the exchange rate, if needed, to prevent serious disruptions to certain sectors of its economy. Be-

cause there is a limit to relying on labour-intensive exports, a rapid and well-sequenced technological upgrading in manufacturing that allows exports to shift to higher value-added and skill-intensive products will require a new strategy, designed to replace imported parts and components with domestic production while placing greater reliance on domestic markets for increasing productive employment. Properly managed, such a process could enable China to leapfrog the industrialization process instead of seeking to absorb the surplus labour in relatively low value-added, labour-intensive manufactures.

Policy Issues

The basic policy issue facing developing countries in the trading system is not, fundamentally, one of more or less trade liberalization, but how best to extract from their participation in that system the elements that will promote economic development. For some this is still a matter of switching from primary commodities, but for many others it is a question of increasing the value-added component of manufacturing exports. The challenges facing China stand as a reminder that even the largest developing economies still require sufficient policy space to manage their integration into the global economy.

Since Seattle, concern has been expressed about the extent to which the multilateral trading rules may foreclose policy options that were part of the successful development strategies in the Asian NIEs as well as in many developed countries. Those concerns might have been eased if the increased market access expected from the Uruguay Round had been realized. Instead, a combination of continued barriers to market access, reduced policy space for nourishing competitive enterprises and promoting technological upgrading, along with excessive competition among developing countries in

world markets for labour-intensive products and for FDI (in the labour-intensive segments of international production networks), has raised once again the risk of fallacy of composition.

At the fourth session of the WTO Ministerial Conference, held in Doha, the concerns of developing countries first raised in Seattle were acknowledged. The challenge now is to make the multilateral trading system more development-friendly. The outcome will be judged by the extent to which developing countries achieve greater market access without their policy options being restricted. The dynamics of the trading system underscore the urgency of making real progress in this respect.

It would be wrong to suggest that making good on the bargain struck in the Uruguay Round by providing improved access to markets in areas of interest to developing countries carries no, or only small, adjustment costs in industrial countries. Prolonged periods of high unemployment and slow growth in those countries have led many low-skilled communities to resist further concessions on trade. But renewed protectionism is not the way forward. Anxieties arising from increased competition can best be addressed by making sure that the full range of macroeconomic and structural policies is employed to accelerate growth and reduce unemployment. That is how developed countries absorbed the entry of low-cost producers in the 1950s and 1960s, and there is no reason to think that the design of a "win-win" package is beyond the technical competence of policy makers in the current era.

Developing countries also need to strike the right policy balance. Continuing efforts to ensure a pro-investment policy regime through an appropriate mix of macroeconomic and market pressures and incentives will be required to meet target growth rates of 6 per cent and above. But much more will be needed to stimulate dynamic export-investment linkages. Developing countries must be able to graduate across the full spectrum of manufacturing in-

dustries to ensure that more of the productive activities generating trade stay at home and to help avert the problems associated with fallacy of composition. This will call for a faster expansion of domestic markets and a rapid technological upgrading through targeted trade and industrial policies and a well-devised approach to FDI. The policies adopted by the East Asian NIEs for this purpose are well known. Success in upgrading, particularly by middle-income countries, will crucially depend on the extent to which obstacles to access to technology and industrial upgrading will be removed in the WTO review process.

Finally, many larger developing countries will need to find ways of utilizing domestic sources of growth more fully. This suggests that the outward orientation of their economies may decline as they grow richer and their home market expands. For smaller countries regional arrangements could provide the right context for galvanizing the forces of trade and industry. These played an important role in East Asia in facilitating the kind of staggered industrialization that is now required on a wider scale. Conventional economic thinking tends to dismiss these as second-best solutions for meeting development goals, and as a potential stumbling block on the road to a fully open and integrated multilateral system. However, these arguments are much less convincing when domestic firms still have weak technological and productive capacities and the global economic context is characterized by systemic biases and asymmetries.

Rubens Ricupero
Secretary-General of UNCTAD

كيفية الحصول على منشورات الامم المتحدة

يمكن الحصول على منشورات الامم المتحدة من المكتبات ودور التوزيع في جميع انحاء العالم . استعلم عنها من المكتبة التي تتعامل معها أو اكتب الى : الامم المتحدة ،قسم البيع في نيويورك او في جنيف .

如何购取联合国出版物

联合国出版物在全世界各地的书店和经售处均有发售。请向书店询问或写信到纽约或日内瓦的联合国销售组。

HOW TO OBTAIN UNITED NATIONS PUBLICATIONS

United Nations publications may be obtained from bookstores and distributors throughout the world. Consult your bookstore or write to: United Nations, Sales Section, New York or Geneva.

COMMENT SE PROCURER LES PUBLICATIONS DES NATIONS UNIES

Les publications des Nations Unies sont en vente dans les librairies et les agences dépositaires du monde entier. Informez-vous auprès de votre libraire ou adressez-vous à : Nations Unies, Section des ventes, New York ou Genève.

КАК ПОЛУЧИТЬ ИЗДАНИЯ ОРГАНИЗАЦИИ ОБЪЕДИНЕННЫХ НАЦИЙ

Издания Организации Объединенных Наций можно купить в книжных магазинах и агентствах во всех районах мира. Наводите справки об изданиях в вашем книжном магазине или пишите по адресу: Организация Объединенных Наций, Секция по продаже изданий, Нью-Йорк или Женева.

CÓMO CONSEGUIR PUBLICACIONES DE LAS NACIONES UNIDAS

Las publicaciones de las Naciones Unidas están en venta en librerías y casas distribuidoras en todas partes del mundo. Consulte a su librero o diríjase a: Naciones Unidas, Sección de Ventas, Nueva York o Ginebra.

Printed at United Nations, Geneva
GE.02-50564
April 2002–5,695

United Nations publication
UNCTAD/TDR/2002 (Overview)